

Message Text

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ACTION SS-25

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FM US MISSION EC BRUSSELS
TO SECSTATE WASHDC 1773

C O N F I D E N T I A L SECTION 1 OF 5 EC BRUSSELS 8555

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FOR UNDER SECRETARY ROGERS AND ASSISTANT SECRETAIRES
GREENWALD AND HARMAN ONLY

E.O. 11652: GDS

TAGS: EEC EAGR US MTN

SUBJECT: US-EC AGRICULTURE PROBLEMS

1. BEFORE COMMENTING ON DRAFT PAPER "BREAKING THE US-EC DEADLOCK
IN AGRICULTURE," I THINK IT WELL TO FIX CLEARLY THE CONTEXT
WITHIN WHICH I SEE THESE NEGOTIATIONS BEING PLAYED OUT.
FIRST IS THE QUESTION OF FUTURE US-EC TRADE PATTERNS AND
PROBLEMS IN THE CONTEXT OF THE GLOBAL FOOD SITUATION OVER
THE COMING YEARS. THE REALITY IS THAT THERE IS NO AGREEMENT
WE CAN REACH THAT WILL ALLOW US TO RECAPTURE ANY SIGNIFICANT
PORTION OF THE EC'S MARKET FOR WHEAT. ON THE OTHER HAND,
THERE IS LITTLE LIKELIHOOD THAT ANY COMBINATION OF EC
POLICIES WILL ELIMINATE THEIR DEPENDENCE ON EXTERNAL SUPPLIERS
(MAINLY US) FOR A PORTION OF THEIR DURUM WHEAT NEEDS AND
A (LARGER) PORTION OF THEIR DOMESTIC FEED GRAIN REQUIREMENTS
OVER THE COMING DECADE OR MORE. IF EC SOFT WHEAT RESERVES
BUILD UP DESPITE GENEROUS, OR BECAUSE OF LIMITED, EC EXPORT
SUBSIDY POLICY, THERE IS SOME DANGER OF DISPLACEMENT OF
US FEED GRAINS BY DENATURED WHEAT. NEVERTHELESS, APART
FROM THIS DIFFICULT-TO-ASSESS SUBSTITUTION POSSIBILITY,
ALMOST REGARDLESS OF THEIR POLICIES AND THE COMMERCIAL
REGIME UNDER WHICH WE OPERATE, THE EC MARKET WILL PROBABLY
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ABSORB AROUND EIGHT TO TEN MILLION TONS OF TOTAL US GRAINS

A YEAR -- OCCASIONALLY MORE OR LESS, DEPENDING ON LOCAL WEATHER DEVELOPMENTS. IN A WORD, THE EC IS NOT A SIGNIFICANT GROWTH MARKET FOR US GRAINS, EXCEPT SOYBEANS.

2. THIS SAID, EC TRADE AND PRODUCTION POLICIES CAN BE HIGHLY DISRUPTIVE TO THE DEVELOPMENT OF US COMMERCIAL MARKETS ELSEWHERE IN THE WORLD, WHERE THE POTENTIAL FOR GROWTH DOES EXIST AND WHICH WILL EXPAND IF A SOLUTION IS FOUND TO THE PROBLEM OF FINANCING SUCH GROWTH (I.E., REAL RESOURCE TRANSFER). THUS, I SEE THE US-EC NEGOTIATING PROBLEM AS A NEED TO MEET TWO OBJECTIVES:

A) THE POLITICAL OBJECTIVE: TO PERMIT THE SATISFACTORY CONCLUSION OF THE MTN AS A WHOLE;

B) THE ECONOMIC OBJECTIVE: TO BUILD ENOUGH DISCIPLINE INTO THE SYSTEM WE NEGOTIATE TO RESTRAIN AND EVENTUALLY ELIMINATE THE CAPACITY OF THE EC TO DISRUPT THIRD MARKETS, TO BEGIN TO APPLY THE PRESSURE THAT WILL HASTEN (IF NOT DIRECTLY PRECIPITATE) THE INTERNAL EC PROCESS OF REFORMING THE CAP TO MAKE IT A MORE BENIGN INSTRUMENT OF POLICY, AND TO REDUCE WHATEVER SUBSTITUTION DANGER REALLY EXISTS.

3. SECONDLY, I BELIEVE IT IS PREFERABLE TO GO FOR A NEGOTIATING OUTCOME WHICH IS COMPATIBLE WITH OUR REAL NEEDS (WHICH I INTERPRET TO MEAN REASONABLY STABLE GROWTH OF GLOBAL MARKETS FOR US AGRICULTURAL EXPORTS) RATHER THAN NARROWLY FOCUSED ON THE UNATTAINABLE OBJECTIVE OF SIGNIFICANT LIBERALIZATION OF THE EC MARKET. THE POLITICS OF THIS MAKES IT DESIRABLE FOR US TO NEGOTIATE A WORKABLE PACKAGE OR PACKAGES WITH THE EC AND THEN LEAVE IT TO CONGRESS TO ACCEPT OR REJECT. BETTER THE ONUS FOR FAILURE REST WITH CONGRESS THAN WITH THE ADMINISTRATION FOR HAVING INSISTED ON NON-NEGOTIABLE GOALS. IN SOME RESPECTS, NO AGREEMENT ON GRAINS AND DAIRY IS PREFERABLE TO BAD ONES WHICH INCREASE THE POTENTIAL FOR SERIOUS ECONOMIC AND FOREIGN POLICY PROBLEMS IN THE YEARS AHEAD.

4. AGAINST THIS BACKGROUND, I BELIEVE THE KEY IDEAS IN DEPARTMENT'S DRAFT PAPER ARE UNLIKELY TO DO THE JOB. WHILE
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BOTH APPROACHES, MONTANT DE SOUTIEN (MDS) AND PRODUCTION-CONSUMPTION RATIO, MIGHT BE INCLUDED ALONG WITH OTHER POSSIBILITIES AS IDEAS TO BE EXPLORED IN INFORMAL TALKS WITH COMMISSION, YOU SHOULD RECOGNIZE THREE MAJOR DIFFICULTIES:

1) FIRST, THERE IS NO EVIDENCE THAT EITHER IDEA WOULD FLY HERE. TWO BASIC EC DOCUMENTS (THE "OVERALL APPROACH" ADOPTED BY THE EC COUNCIL IN JUNE 1973 AND THE "NEGOTIATING

DIRECTIVES" DRAWN UP IN APRIL 1975) RELATING TO TOKYO ROUND, GIVE NO HINT OF RETURN TO EC'S KENNEDY ROUND MDS PROPOSAL, PERHAPS BECAUSE BASIC SITUATION IN WORLD GRAIN TRADE IS TODAY QUITE DIFFERENT, AND EC WOULD BE HARD UP TO FIND EVEN FICTITIOUS MDS RECIPROCITY IN GRAIN SECTOR. WHAT WOULD WE DO, PROMISE TO MAINTAIN US MDS AT ZERO? AS FAR AS WE ARE AWARE, PRODUCTION-CONSUMPTION IDEA HAS NEVER BEEN SERIOUSLY CONSIDERED IN EUROPE, AND AGAIN IT IS HARD TO SEE WHERE RECIPROCITY WOULD COME FROM. MORE TO THE POINT, IT WOULD BE SEEN AS A DIRECT CHALLENGE TO INTEGRITY OF THE CAP, AND THAT BY DEFINITION IS A NON-STARTER. OUR JOB IS HARD ENOUGH WITHOUT PUTTING FORWARD PROPOSALS THAT CANNOT EVEN SUPERFICIALLY BE RELATED TO THE EXISTING EC MANDATE. THE SUGGESTIONS ADVANCED BELOW DO HAVE THE APPEARANCE OF COMPATIBILITY WITH THE EC OVERVIEW ALTHOUGH IN DETAIL THEY AIM AT BUILDING ON EC CONCEPTS TO MEET OBJECTIVES WELL STATED IN DEPARTMENT'S PAPER.

2) SECOND, AS DEPARTMENT'S PAPER SUGGESTS, THERE IS NO REASON TO BELIEVE US FARM COMMUNITY WOULD BUY SUCH IDEAS.

3) THIRD, CONTRARY TO ASSERTION IN PAPER THAT TECHNICAL PROBLEMS WOULD PROVE TO BE "MANAGEABLE," I HAVE GRAVE DOUBTS. PRODUCTION-CONSUMPTION RATIO COMMITMENTS WOULD BE DIFFICULT TO MEASURE AGAINST DAILY DECISIONS ON AGRICULTURAL POLICY. FOR GRAINS, RECIPROCITY REQUIREMENT WOULD BE TRICKY; FOR DAIRY, EITHER IDEA WOULD BE INCREDIBLY COMPLEX AS WELL AS POLITICAL DYNAMITE. IN SHORT, THAT GAME IS NOT WORTH THE CANDLE.

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C O N F I D E N T I A L SECTION 2 OF 5 EC BRUSSELS 08555

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5. ON THE OTHER HAND, MERIT OF IDEAS IS THAT BOTH APPROACHES GET BACK, ALBEIT INDIRECTLY, TO FUNDAMENTALS OF PROBLEM, TO WIT, DOMESTIC EC SUPPORT POLICIES, ESSENTIALLY PRICE POLICY. THIS IS ALSO, OF COURSE, BASIC ISSUE ABOUT US DAIRY POLICY. IT IS FUNDAMENTAL, I THINK, TO RECOGNIZE THAT US SECTION 22 GATT WAIVER AND US MEAT QUOTAS, AS WELL AS EC VARIABLE LEVIES, EXPORT SUBSIDIES, ETC., ARE SYMPTOMS OR SECONDARY MANIFESTATIONS OF THE FUNDAMENTAL DOMESTIC AGRICULTURE POLICIES WHICH EXIST BECAUSE OUR RESPECTIVE SOCIETIES WEIGHT POLITICAL AND SOCIAL CONCERNS IN AGRICULTURE FAR MORE HIGHLY THAN ECONOMIC EFFICIENCY CRITERIA OR PRINCIPLE OF COMPARATIVE ADVANTAGE. WOULD IT WERE OTHERWISE, BUT IT ISN'T. INDEED, IN EUROPE, THE POLITICAL FEASIBILITY OF PERMITTING MORE COMPETITIVE PRESSURE ON THE AGRICULTURAL SECTOR, NEVER GREAT, IS EVEN LESS AT PRESENT, GIVEN THE DEGREE OF UNEMPLOYMENT IN MANUFACTURING AND SERVICES.

6. AS IF THIS WERE NOT ENOUGH, WE SHOULD RECOGNIZE THAT THERE IS FUNDAMENTAL PHILOSOPHICAL DIFFERENCE BETWEEN OUR APPROACH TO AGRICULTURE IN AREAS WHERE WE ARE EXPORTERS AND THE EUROPEAN APPROACH. WE STRESS MARKET FORCES, THE EUROPEAN SEEK PRICE STABILITY. EXCEPT FOR DAIRY, MEAT, CONFIDENTIAL

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PEANUTS, AND A FEW OTHER PRODUCTS WHERE WE FACE IMPORT PRESSURE, WE SEEK TO MINIMIZE GOVERNMENT INTERVENTION WHEREAS CAP IS EPITOME OF GOVERNMENT-ORGANIZED AGRICULTURAL SYSTEM. ONLY STATE TRADERS GO FURTHER THAN COMMUNITY IN MARKET INTERVENTION. MOREOVER, FARM ATTITUDES IN US FOR HISTORICAL REASONS TEND TO SUPPORT MINIMUM GOVERNMENT ROLE EXCEPT IN PERIODS OF SERIOUSLY DEPRESSED PRICES WHEREAS FARM ATTITUDES IN EUROPE PRESS CONSTANTLY FOR MORE GOVERNMENT INTERVENTION AND SUBSIDY. WHILE EC FINANCE MINISTERS AND SOME CONSUMER GROUPS RECOGNIZE HOW COSTLY THE CAP HAS TURNED OUT TO BE, SO FAR THE PRODUCER GROUPS GET BETTER PART OF ALMOST EVERY ARGUMENT AND NO ONE HERE WOULD PROPOSE REFORM WITHOUT PROVIDING FOR MAINTENANCE OF FARMER INCOME IN ONE FORM OR ANOTHER.

7. NEVERTHELESS, IT IS COST OF CAP TO CONSUMERS AND TAX PAYERS THAT IS PRIMARY SOURCE OF DISCIPLINE ON CAP. THE SECONDARY SOURCE OF DISCIPLINE IS THE DUTY FREE AVAILABILITY OF OILSEEDS, I.E., OUR GATT SOYBEAN CONCESSION, WHICH

WORKS BECAUSE OF POSSIBLE AND ACTUAL SUBSTITUTION EFFECTS TO RESTRAIN INCREASES IN CAP GRAIN INTERVENTION PRICES. THIS LATTER CONSIDERATION PARTLY EXPLAINS BOTH WHY ILLINOIS IS BEGINNING TO ATTACK OUR CONCESSION AND THE CRITICAL NECESSITY OF MAINTAINING IT IF TRADE PROSPECTS ARE NOT TO WORSEN NOT ONLY IN THE OILSEED SECTOR BUT MORE GENERALLY. THAT RELATIVE DISCIPLINE EXISTS FOR GRAINS IS EVIDENCED BY FACT THAT NOMINAL INTERVENTION PRICE FOR WHEAT HAS INCREASED ONLY 33 PERCENT SINCE 1969/70 CROP YEAR AND CORN 46 PERCENT WHILE NFDI INTERVENTION PRICE IS UP 121 PERCENT AND SUGAR 57 PERCENT. FOR GRAINS THERE IS EVEN DECREASE IN REAL PRICES FOR THIS PERIOD OF CAP.

8. IF THERE IS A WAY IN THE TOKYO ROUND TO GET SIGNIFICANT PROGRESS ON AGRICULTURAL TRADE IN GRAINS AND DAIRY AS DISTINCT FROM COSMETIC PROGRESS, AND I AM FAR FROM CERTAIN THAT IT CAN BE DONE, WE MUST SEEK THE ANSWERS BY DEVELOPING COMMON GROUND AND TRYING FOR POLITICALLY ACCEPTABLE COMPROMISES ON PHILOSOPHY. AS IN DISARMAMENT NEGOTIATIONS, WORLD INTERESTS, COST LIMITATION, AND GRADUALISM OFFER SOME HOPE.

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9. IF THE US-EC DEADLOCK IS FRAMED IN TERMS OF MARKET ACCESS, AS IT IS WITH MDS AND PRODUCTION-CONSUMPTION RATIOS, THE ISSUES BECOME THE MORE INTRACTABLE. IT IS THEREFORE CRITICAL TO MOVE THE DEBATE ONTO OTHER GROUND. SECRETARY KISSINGER'S WORLD GRAIN RESERVE PROPOSAL DID THIS, AND I FEEL STRONGLY THAT SINCE THE EC HAS ACCEPTED THAT IDEA IN PRINCIPLE, IT SHOULD BE THE STARTING POINT FOR A MORE INTENSE SEARCH FOR COMPROMISE. WE SHOULD TALK ABOUT WORLD FOOD PROBLEMS, NOT ACCESS, AND BEAR IN MIND THAT WITHIN DECADE WE MAY WANT MORE NOT LESS EC PRODUCTION. AT SAME TIME, SINCE WE CANNOT RELY ON PROJECTIONS OF EITHER WORLD SURPLUS OR SHORTAGE IN COMMERCIAL MARKET SENSE, THE SYSTEM HAS TO BE FLEXIBLE ENOUGH TO HELP IN EITHER CASE.

10. THE KEY TO SUCCESS IN THE GRAINS NEGOTIATIONS WILL BE TO DEVISE A SYSTEM WITH ENOUGH COMMITMENTS ABOUT HOW GOVERNMENTS WILL MANAGE THE CONDITIONS UNDER WHICH TRADE OCCURS TO REALIZE OUR ESSENTIAL OBJECTIVES WITHOUT APPEARING TO REQUIRE VERY SIGNIFICANT CHANGES IN THE WAY EACH SIDE (AGRICULTURE MINISTERS OR CONGRESS) MAKES AND IMPLEMENTS ITS OWN DOMESTIC FARM POLICIES.

11. IN WHAT FOLLOWS, IT IS IMPORTANT TO DISTINGUISH BETWEEN TWO KINDS OF RESERVES. FIRST IS THE MINIMUM INTERNATIONAL SYSTEM OF NATIONAL RESERVES PROPOSED BY SECRETARY KISSINGER WHICH I REFER TO AS THE 30 MILLION TON

RESERVE. (THOUGH THIS IS CURRENTLY LIMITED TO WHEAT AND RICE, I LEAVE TO OTHERS TO DETERMINE WHETHER FEED GRAINS SHOULD BE ADDED AND THE TOTAL INCREASED.) IN MOST CASES, THIS RESERVE WOULD BE HELD BY GOVERNMENTS, AND IT MAY DEVELOP THAT, TO BE CREDIBLE, WE ALSO WOULD HAVE TO CONSTITUTE OUR SHARE IN THE FORM OF GOVERNMENT-OWNED STOCKS. AT LEAST USG MUST HAVE FEASIBLE MECHANISM TO ASSURE THAT THEY WOULD IN FACT BE RELEASED WHEN REQUIRED BY THE AGREEMENT. THESE RESERVES WOULD BE CONSTITUTED IN ACCORDANCE WITH AN AGREED SCHEDULE (E.G., EACH PARTICIPANT WOULD BE COMMITTED TO HAVE HIS STOCKS IN PLACE WITHIN, SAY, THREE YEARS, UNLESS THE COUNCIL OF PARTICIPANTS RULED (E.G., BY WEIGHTED MAJORITY VOTE) TO FOREGO THE REQUIREMENT IN ANY GIVEN YEAR (E.G., A WORLD SHORTAGE EXISTS, ETC.). THERE MIGHT OR MIGHT NOT BE NEED FOR FIXED RESERVE ACCUMULATION PRICE
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UNDER THIS PORTION OF THE SYSTEM.

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C O N F I D E N T I A L SECTION 3 OF 5 EC BRUSSELS 08555

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12. THE SECOND KIND OF RESERVES ARE THOSE WHICH MAY BE

CONSTITUTED IN ANY GIVEN YEAR PURSUANT TO THE RULES OF THE TRADING SYSTEM AS OUTLINED BELOW. ALL GRAINS WOULD BE INVOLVED IN THIS PART OF THE SYSTEM. THESE COULD BE GOVERNMENT OR PRIVATELY HELD (AT LEAST IN OUR CASE) AND WOULD BE IN ADDITION TO THE MINIMUM REQUIRED BY THE 30 MILLION TON SYSTEM. FOR THESE STOCKS, THERE WOULD BE A MANDATORY ACCUMULATION PRICE, BUT NO MANDATORY RELEASE PRICE (AS EXPLAINED BELOW).

13. WITH THIS PROLOGUE, THE TRADING SYSTEM MIGHT BE DESIGNED AS FOLLOWS:

A) BUILDING ON THE US-EC CONCEPTUAL AGREEMENT IN PRINCIPLE TO AN INTERNATIONAL SYSTEM OF GRAIN RESERVES, WE COULD PROPOSE A SYSTEM OF FLOOR AND CEILING PRICES WHICH WOULD TRIGGER RESERVE ACCUMULATION OR RELEASE. THE FLOOR PRICE WOULD BE THE SAME AS THE US LOAN RATE -- PRESUMABLY TO RAISED SUBSTANTIALLY DURING THE NEGOTIATIONS (IF NOT BEFORE) BY THE NEXT CONGRESS TO BETTER REFLECT INCREASES SINCE 1973 IN COSTS OF PRODUCTION FACTORS. THERE WOULD BE AN ENFORCEABLE MINIMUM WORLD TRADING PRICE BUT THE CEILING PRICE WOULD BE A PRICE AT WHICH CAP CONTROLS WOULD DROP AWAY AND THE MARKET WOULD BE RELIED ON TO RATION SUPPLIES. THE SYSTEM CONFIDENTIAL

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WOULD INCLUDE:

1) THE FLOOR PRICE (DEFINED AS THE US LOAN RATE LEVEL, CURRENTLY \$55/TON FOR WHEAT AND \$50/TON FOR CORN) WOULD BE THE LOWEST AT WHICH INTERNATIONAL TRADE COULD OCCUR. IF WORLD PRICES REACHED THAT LEVEL, PARTICIPANTS WOULD HAVE TO ADD TO RESERVES (IF NECESSARY, IN EXCESS OF AGREED NATIONAL TARGET AMOUNTS ALREADY CONSTITUTED UNDER THE 30 MILLION TON RESERVES AGREEMENT) AND, WHILE PRICES ARE AT FLOOR, REFRAIN FROM ANY INCREASES IN SUPPORT PRICES OR OTHER PRODUCTION INCENTIVES. A COUNCIL OF PARTICIPANTS IN THE AGREEMENT (PERHAPS BY WEIGHTED MAJORITY VOTE) OR SOME OTHER INTERNATIONAL MECHANISM MIGHT BE PROVIDED FOR TO AGREE (IF THE FLOOR WERE EVER REACH) TO A FORMULA UNDER WHICH SALES WOULD BE ALLOCATED AMONG SUPPLIERS IN ORDER TO PREVENT THE PREDATORY MARKETING PRACTICES WHICH DESTROYED THE KENNEDY ROUND IGA. INCREMENTAL EXPORT SUBSIDIES THAT WOULD REDUCE ANY COUNTRY'S EXPORT PRICE BELOW THE FLOOR PRICE WOULD, OF COURSE, BE PROHIBITED ABSOLUTELY AT THIS LEVEL. SINCE THE FLOOR PRICE WOULD BE THE SAME AS THE US LOAN RATE, WHICH THE US MUST ACT TO DEFEND ANYWAY, THE CONCEPT (EXCEPT FOR POSSIBLE MARKET ALLOCATION) BECOMES EASIER TO SELL TO US FARM GROUPS AND WOULD REQUIRE NO NEW LEGISLATION AUTHORITY.

2) THE CEILING PRICE WOULD ENTAIL DIFFERENT OBLIGATIONS. TI WOULD BE DEFINED AS THE EC TARGET PRICE FOR EACH GRAIN (CURRENTLY ABOUT \$180/TON FOR WHEAT AND \$165/TON FOR CORN).

WHEN WORLD PRICES REACHED THOSE LEVELS, GOVERNMENTS WOULD BE REQUIRED TO RELEASE--PERHAPS IN TRANCHES--AT LEAST THOSE RESERVES ACCUMULATED PURSUANT TO THE 30 MILLION TON SYSTEM. GOVERNMENTS WOULD ALSO BE REQUIRED TO REFRAIN FROM INTER-FERRING WITH REGULAR COMMERCIAL EXPORTS, EITHER THROUGH IMPOSING EXPORT TAXES, QUANTITATIVE LIMITS, OR OTHERWISE ARBITRARILY HOLDING SUPPLIES OFF THE MARKET (E.G., BY WHEAT BOARDS). NATURALL, THESE SUPPLY COMMITMENTS WOULD ONLY BE BINDING ON SHIPMENTS TO OTHER PARTICIPANTS IN THE SYSTEM, THUS FACING NON-PARTICIPANTS WITH THE RISK OF HAVING TO PAY PRICE PREMIUMS OR SEE SUPPLIES LIMITED OR OTHER APPROPRIATE SANCTIONS. UNDER THIS ARRANGMENT, GOVERNMENTS WOULD NOT BE COMMITTED TO MAINTAIN ANY MAXIMUM TRADING PRICE, ONLY TO ACT TO DAMPEN UPWARD PRICE PRESSURE BY MAINTAINING ACCESS TO THEIR SUPPLIES AND BY RELEASING

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RESERVES. IN DEED, IF ATTAINABLE, EC COMMITMENT NOT TO USE CAP TO LIMIT EXPORTS IN TIMES OF WORLD SHORTAGE WOULD SERVE TO REDUCE PRICE PRESSURE ON US MARKET. THE OTHER FEATURE OF THIS SYTEM IS THAT INTERNATIONAL AGREEMENT TO THE OUTER LIMITS OF THE PRICE FORK --WHICH IS ONLY A FORK FOR SPECIFIED PURPOSES --IS ACHIEVED BY ADOPTION OF WHAT EXISTS, THE BAND IS WIDE AND THE PROBLEM OF A "REFERENCE WHEAT" WHICH PLAGUED THE KENNEDY ROUND AGREEMENT IS MORE MANAGEABLE. THE LIMITS WOULD BE SET BY THE US (AT THE LOWER LIMIT) AND THE EC AT THE UPPER LIMIT. WHILE THE CANADIANS AND AUSTRALIANS MIGHT GRUMBLE, I SUSPECT THEY COULD BE PERSUADED TO ACCEPT IT.

B) IF OUTER LIMITS COULD BE AGREED ALONG THESE LINES, THE CRITICAL ELEMENT THEN BECOMES THE DISCIPLINES WHICH OPERATE ON GOVERNMENT BEHAVIOR WHEN PRICES, AS THEY NORMALLY WOULD BE, ARE BETWEEN THESE TOW WIDE EXTREMES. OUR INTEREST IS IN PREVENTING THE DEVELOPMENT OF A SITUATION IN WHICH PRICES ARE FORCED DOWN TO THE MANDATORY FLOOR BY POLICIES OF OTHER GOVERNMENT (I.E., EXCESSIVE PRICE SUPPORTS, EXPORT SUBSIDIES, ETC.) THUS, MUCH OF THE NEGOTIATION WOULD CENTER AROUND THE CRITERIA FOR DETERMING WHEN A SURPLUS SITUATION EXISTS OR THREATENS AND THE ACTIONS TO BE TAKEN IN THAT EVENT.

14. SINCE US AND EC SUPPORT LEVELS WILL DIFFER BY CONSIDERABLE AMOUNTS, WE COULD NOT AGREE TO SYSTEM BY WHICH DE FACTO SURPLUS COULD ONLY BE DECLARED (AND ACTION TAKEN) WHEN WORLD PRICE DIPPED TO US LOEAN RATE. SIMILARLY, EC WOULD NOT AGREE TO FLAT PROHIBITION ON EXPORT SUBSIDIES OR REQUIREMENT TO ADD TO NORMAL RESERVES JUST BECAUSE WORLD PRICE IS LESS THAN EC SUPPORT PRICE. THUS, THE RANGE BETWEEN EC SUPPORT PRICE AND US PRICE IS THE CRITICAL ONE TO FOCUS ON.

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C O N F I D E N T I A L SECTION 4 OF 5 EC BRUSSELS 8555

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GREENWALD AND HARTMAN ONLY

15. FIRST, AS TO DETERMINING WHETHER A SURPLUS EXISTS OR IS THREATENING, WE MIGHT INTRODUCE THE CONCEPT OF PRICE MOVEMENT AND AMPLITUDE AS A CRITERIA. FOR EXAMPLE, IF THE WORLD PRICE WERE TO DECLINE OVER A PERIOD OF X WEEKS BY AN AVERAGE OF Y PERCENT, PARTICIPANTS WOULD BE REQUIRED TO CONSULT WITH A VIEW TO DETERMINING WHETHER A SURPLUS EXISTS OR IS PROBABLE. ASSUMING THEY DON'T AGREE, A SECOND THRESHOLD, INVOLVING A DECLINE OF Z PERCENT, OR MORE SIMPLY A PREVIOUSLY AGREED WARNING PRICE WHICH WOULD BE ABOVE THE US SUPPORT PRICE, WOULD TRIGGER ACTION ALONG THE FOLLOWING LINES:

1) EXPORERS COULD FULLY SUBSIDIZE DOWN TO THE WORLD MARKET PRICE (IN PRACTICE, THE US PRICE) BUT FOR EVERY TON SUBSIDIZED, THEY WOULD HAVE TO ADD A TON TO THEIR RESERVES. (US, OF COURSE, WOULD NOT BE AFFECTED.)

2) AN ALTERNATIVE TO THE ABOVE MIGHT BE TO NEGOTIATE AN AGREED BUDGETARY CEILING ON THE TOTAL AMOUNT TO BE SPENT BY EXPORTERS ON SUBSIDIES, WITH A SCHEDULED REDUCTION (TO ZERO) OVER X YEARS. THIS ALSO OFFERS SOME ADMINISTRATIVE FLEXIBILITY TO THE EC AND MIGHT APPEAL DIRECTLY TO FINANCE MINISTERS AND TAXPAYERS, ESPECIALLY GERMAN TAXPAYERS WHO

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BEAR MOST OF THE COST.
EFFECT OF EITHER REQUIREMENT WOULD BE TO LIMIT EC SUBSIDIZED
EXPORS (OUR OBJECTIVE IN RELATIVE SURPLUS SITUATION) BUT
TO GIVE EC FLEXIBILITY IN HOW THEY DID THIS (THUS, NOT
INTERFERRING DIRECTLY IN CAP OPERATIONS). IT SHOULD ALSO
PROTECT OUR ESSENTIAL INTERESTS WHILE LEAVING EC FREE,
EXCEPT AT FLOOR, TO SET INTERNAL PRICES AS THEY CHOOSE.
AT SOME POINT DOWN THE LINE, THE COMBINED COSTS OF
SUBSIDIZING AND/OR STORAGE WOULD EXERT PRESSURE ON EC
TO LIMIT UNECONOMIC PRODUCTION. POINT IS, WE WOULD NOT
NORMALLY BE FORCING THEM TO DO SO AT AN UNACCEPTABLE (TO
THEM) ACE.

C) THE ABOVE COMMITMENTS WOULD OPERATE ANNUALLY, REGARDLESS
OF THE STATE OF 30 MILLION TON RESERVE SYSTEM. COMMITMENTS
TO ADD TO RESERVES WOULD BE ABSOLUTE AT THE PRICE FLOOR
(REGARDLESS OF WHETHER EACH COUNTRY'S AGREED TARGET AMOUNT
HAD BEEN REACHED) AND OPTIONAL AT LEVELS SHORT OF THE
CEILING. RATE OF RESERVE RELEASE OF BASIC 30 MILLION TONS COULD
PERHAPS BE SUBJECT TO NEGOTIATION AND AGREEMENT IN THE COUNCIL OF
PARTICIPANTS. HOWEVER, RELEASE BELOW THE CEILING PRICE
OF RESERVES HELD BY GOVERNMENTS OR CONSTITUTED PURSUANT TO
THE 30 MILLION TON SCHEME WOULD BE PROHIBITED UNLESS THE
COUNCIL DECIDED OTHERWISE (E.G., BY WIGHTED MAJORITY VOTE).
PRIVATELY HELD STOCKS IN EXCESS OF A GOVERNMENT'S MINIMUM
RESERVE UNdertaking COULD, OF COURSE, BE SOLD AT ANY PRICE.
EC TRADERS, UNLESS SUBSIDIZED, WOULD NOT SELL AT PRICES
BELOW EC SUPPORT LEVELS (I.E., THE CILING PRICE) BUT
OUR TRADERS WOULD AND COULD. THIS COINCIDENCE OF INTERESTS
SHOULD HELP DISSELL US FARMER FEARS OF OF THE PRICE-DEPRESSING
EFFECTS OF A LARGE RESERVE OVERHANG.
D) THERE WOULD BE SPECIAL RULES FOR FOOD AID, ASSISTANCE
TO LDC'S ON RESERVE CONSITUION, TREATMENT OF NON-
PRTICIPANTS, DISPUTE SETTLEMENT, ETC.

16. OBVIOUSLY, THE FEATURE OF THIS SCHEME WHICH CAUSES
THE MOST DAMAGE TO US PHILOSOPHY IS THE ROLE OF PRICES
AND GOVERNMENTS. I WOULD HOPE THAT THE WAY I HAVE DEFINED
PRICES WOULD HELP MAKE IT MORE PALATABLE SINCE IN EFFECT
THERE IS A FLOOR BUT NO REAL CEILING, I.E., A COMPROMISE
BETWEEN US AND EC STARING POSITIONS. ALSO, I WOULD
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EMPHASIZE THAT THE UPPER LIMIT OF "THE FORK" IS BOTH HIGH

AND, MORE IMPORTANT, NOT RPT NOT A CEILING AT WHICH GRAIN
WOULD ACUTALLY BE TRADED. THE LATTER WOULD BE INFLUENCED
BY THE RATE OF RESERVE RELEASE, BUT MIGHT WELL EXCEED THE
EC SUPPORT PRICE. IN ANY CASE, THE COMMITMENT OF GOVERN-
MENTS AT THE UPPER LIMIT IS TO RELEASE SUPPLIES TO THE
MARKET AND TO AVOID INTERFERENCE (E.G., EXPORT TAXES) TO
FORCE INTERNAL PRICES TO STAY AT OR BELOW THAT LEVEL. I
WOULD ALSO STRESS THE ADVANTAGES TO US FARMERS AND EXPORTERS
OF THE COMMITMENTS TO MITIGATE DISRUPTIVE PRACTICES IN THEIR
GLOBAL MARKETS AND THE PROTECTION AFFORDED IN SURPLUS
SITUATIONS. FINALLY, I THINK IT WOULD BE DIFFICULT FOR
TOO MANY CONGRESSMEN TO ARGUE PUBLICLY AGAINST A SYSTEM
(RESERVES AND EC POLICY CHANGE) WHICH WILL HELP PROTECT
CONSUMERS AGAINST EXCESSIVELY HIGH PRICES IN TIMES OF
SHORTAGE AND FARM INCOME IN TIME OF SEVERE SURPLUS. IN
SUM, IT MAY LOOK LIKE A COMMODITY AGREEMENT, SINCE IT IS, BUT
ONLY A COMMODITY AGREEMENT IS LIKELY TO BE NEGOTIABLE OR TO WORK
AS FAR AS GRAINS TRADE IS CONCERNED.

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C O N F I D E N T I A L SECTION 5 OF 5 EC BRUSSELS 08555

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FOR UNDER SECRETARY ROGERS AND ASSISTANT SECRETARIES
GREENWALD AND HARTMAN ONLY

17. IF WE COULD INTEREST RESPONSIBLE EC INTERLOCUTORS
IN THE BROAD OUTLINE OF A GRAINS SOLUTION ALONG THE
ABOVE LINES, THE QUESTION OF WHERE AND WITH WHOM TO
NEGOTIATE IT FORMALLY SHOULD BE EASILY RESOLVABLE.
THE MAIN REASONS FOR THE LONDON-GENEVA IMPASSE (DISTRUST

OVER REAL NEGOTIATING OBJECTIVES) WOULD HAVE BEEN REMOVED. MY RECOMMENDATION WOULD BE TO MOVE THE WHOLE SHOW TO GENEVA, INVITING THE SOVIETS, AND IF THEY DECLINE, KEEPING THEM INFORMED OF WHAT WE ARE DOING. WHEN AGREEMENT IN PRINCIPLE HAD BEEN REACHED IN GENEVA ON BOTH 30 MILLION TON RESERVE SCHEME AND ON BROADER TRADE RULES, THE IWC NEGOTIATING GROUP COULD BE RECONSTITUTED, IN LONDON, HOPEFULLY WITH SOVIETS, TO WORK OUT DETAILED LANGUAGE.

18. GIVEN THE RISK THAT CONGRESS MIGHT ACCEPT A LIMITED RESERVE SCHEME BUT REJECT A TRADE SYSTEM WITH PRICE PROVISIONS, ETC., IT WOULD BE IMPORTANT TO KEEP THE PIECES SEPARATE. ALSO, ARGUING FOR SEPARABILITY IS FACT THAT MORE TIME MIGHT WELL BE NEEDED TO NEGOTIATE GRAINS AGREEMENT THAN REST OF TOKYO ROUND. THE BASIC 30 MILLION TON RESERVE SYSTEM WOULD CONTAIN NO EXPLICIT TRADE OR PRICE PROVISIONS AND BE LIMITED SOLELY TO A COMMITMENT TO CONSTITUTE NATIONAL RESERVES, CONSULT ABOUT THEIR USE, ASSIST CONFIDENTIAL

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LDC'S, AND MATTERS OF COUNCIL STRUCTURE. THUS, IF THE GUTS OF THE AGREEMENT--RULES OF BEHAVIOR (TO BE DEFINED IN A FORMAL FATT AGREEMENT) --WERE REJECTED, WE MIGHT STILL BE ABLE TO SALVAGE A "BEST EFFORTS" RESERVES STRUCTURE, FOR WHAT THAT WOULD BE WORTH. IN ANY CASE, WE AND THE EC PLAYERS WOULD HAVE TO HAVE REACHED REASONABLY FULL AGREEMENT ON NEGOTIATING PROCEDURES AND SUBSTANTIVE OBJECTIVES TO HAVE ANY CHANCE OF SUCCESS.

19. FOR DAIRY, MATTERS ARE EVEN MORE COMPLEX BOTH BECAUSE THERE ARE MORE ACTORS INVOLVED AND PRODUCT DIFFERENTIALS ARE EVEN GREATER THAN IN GRAINS. THE BEST DEAL WE COULD NEGOTIATE WOULD BE TO TRADE OUR QUOTAS FOR AN AGREEMENT FROM OTHERS TO REFRAIN FROM SUBSIDIZING EXPORTS TO OUR MARKET. SINCE THAT IS PROBABLY NOT ACCEPTABLE DOMESTICALLY (ALTHOUGH WE SHOULD STILL GO FOR IT), WE MIGHT CONCENTRATE OUR EFFORTS ON NEGOTIATING A LONG-TERM MODUS OPERANDI TO REPLACE THE CURRENT SET OF BILATERAL DEALS ON CHEESE AND SUBSIDIES WHEN THAT AUTHORITY EXPIRES IN JANUARY 1979. SOMETHING LIKE THE DEAL WE NEGOTIATED AND THEN DROPPED WITH THE EC IN THE SPRING OF 1975 (MINIMUM EXPORT PRICES) OUGHT TO BE TRIED AGAIN WITH A NEW CONGRESS.

20. AS FOR MEAT, FOR OUR OWN DOMESTIC ECONOMIC POLICY AS WELL AS FOREIGN POLICY REASONS, WE SHOULD SCRAP THE QUOTA SYSTEM, BUT WE PROBABLY WON'T FOR POLITICAL REASONS. THE EC SYSTEM IS WORSE BUT THEY HAVE NO REAL INTEREST IN OUR QUOTAS OR IN SERIOUS LIBERALIZATION, SO NEGOTIATION HERE SHOULD REST WITH THE MAIN MEAT EXPORTERS. IF WORLD GRAIN PRICES EVENTUALLY COVERGE (AS THEY WOULD TEND TO DO UNDER

THE GRAINS AGREEMENT OUTLINED ABOVE), LIBERALIZATION OF MEAT TRADE MAY BECOME FEASIBLE. IN THE INTERIM, OUR INTERESTS WOULD PROBABLY BE SERVED BY EC ADOPTION OF A QUOTA SYSTEM NOT WHOLLY UNLIKE OUR OWN, THUS AT LEAST RELIEVING OUR MARKET OF SOME OF THE PRESSURE ON IT FROM AUSTRALIA ET AL.

21. AS FOR OILSEEDS, WE ARE BETTER OFF WITH WHAT WE HAVE THAN WITH ANY OTHER CONCEIVABLE ARRANGEMENT, AND I FOR ONE WOULD RATHER KEEP THE OVERALL AGRICULTURAL STATUS QUO THAN TOUCH THIS ONE. I MUST WARN, HOWEVER, THAT THE EC MAY WELL
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DECIDE TO WITHDRAW THEIR BINDING AND INSTITUTE A VARIABLE LEVY SYSTEM IF WE DO NOT MOVE ON CHEESE, HAM, AND GRAINS.

22. FINALLY, FOR TARIFF ITEMS, IF WE CAN SUMMON THE COURAGE TO AGREE TO NEGOTIATION OF SOMETHING LIKE THE GRAIN AGREEMENT SKETCHED ABOVE, I WOULD LINK SUCH A MOVE TO EC AGREEMENT TO APPLY THEIR TARIFF-CUTTING FORMUAL TO NON-VARIABLE LEVY AGRICULTURAL IMPORTS. SUCH A CONCESSION FROM THEM WOULD MAKE IT EASIER TO SPLIT OFF AS DIFFERENT GRAINS AND DAIRY SINCE PRESENTATIONALLY WE COULD ARGUE DOMESTICALLY THAT SOME AGRICULTURE WAS BEING TREATED LIKE INDUSTRY, AND SUBSTANTIVELY IT WOULD INCREASE THE CHANCE THAT WE WOULD HAVE SOMETHING AT THE END OF THE ROAD TO WHICH TO POINT WITH PRIDE.

23. IF, ON REFLECTION AND DISCUSSION, DENT, YEUTTER, AND BUTZ WON'T OK A TRY ALONG THE ABOVE LINES, WE HAD BETTER LOWER OUR TOKYO ROUND SIGHTS AND BEGIN EXPLAINING TO CONGRESS, US AGRICULTURE, AND THE PUBLIC THE FACTS OF LIFE. THE WORST COUSE OF ACTION WOULD BE TO CONTINUE TO DIG OURSELVES IN DEEPER PUBLICLY ON OUR CURRENT LINE THAT BORDER MANIFESTATIONS OF DOMESTIC AGRICULTURAL POLICIES, WHETHER EXPORT SUBSIDIES OR IMPORT RESTRICTIONS, IN AND BY THEMSELVES ARE GOING TO BE SUBSTANTIALLY LIBERALIZED. IT JUST ISN'T IN THE CARDS.

24. THUS, AS YOU AND THE SECRETARY HAVE RECOGNIZED ALL ALONG, THE IDEA OF INFORMAL EXPLORATORY TALKS WITH THE COMMISSION IS HIGHLY IMPORTANT. BEFORE GOING FURTHER IN GENEVA, WE REALLY DO NEED TO KNOW WHAT OUR FRIENDS THINK IS NEGOTIABLE AND WHAT IS NOT. HINTON

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